United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

ORIGINAL

To Be Argued By
GABRIEL KASZOVITZ

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

75-7288

B

NATHAN CHANOFSKY,

Plaintiff-Appellant,

-against-

THE CHASE MANHATTAN CORPORATION,

Defendant-Appellee.

P/S

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE SOUTHERN
DISTRICT OF NEW YORK

UNITED STATES COURT OF APPEALS
FILED
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PLAINTIFF-APPELLANT'S REPLY BRIEF

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UNITED STATES COURT OF APPEALS
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NATHAN CHANOFSKY,

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------------------------------------ X

PLAINTIFF-APPELLANT'S REPLY BRIEF

POINT I

THE DISTRICT COURT'S ERROR, IN RELYING ON SUBSEQUENT RISES IN THE MARKET PRICES OF CHASE SECURITIES, IS HIGHLIGHTED BY THE RECENT DECISION IN HARRIS V. AMERICAN INVESTMENT CO.

Harris v. American Investment Co., CCH Fed. Sec. L. Rep. ¶195,208, (8th Cir., June 18, 1975), was a class action involving the purchase by plaintiff of the defendant corporation's publicly traded (New York Stock Exchange) shares. The plaintiff claimed that the defendant corporation failed to disclose material information (merger proposals from other corporations) and that it published

false and misleading financial statements during the period that plaintiff purchased defendant's shares.

Plaintiff purchased his shares on August 4, 1969, when the market was $18 7/8. The market was constant for a time, but by June 30, 1970 the price of the stock had fallen to $7.50. The plaintiff claimed that the fraud he was complaining about was an on-going scheme of misrepresentation, and that he first discovered the true facts in the fall of 1970, at which time the stock was selling for $9.00 per share. His complaint was filed on April 8, 1971, at which time the stock was selling at $16.00. The plaintiff still had not sold any of his shares at the time he commenced the class action.

The District Court dismissed the complaint in Harris upon the same grounds that the complaint in this proceeding was dismissed by the Court below: namely that the plaintiff was not damaged since he could have sold his securities at a profit as the result of subsequent rises in the market prices of the securities involved. In Harris, the lower Court held that:

> "The defendants' contention is that the undisputed facts in this case disclose that plaintiff has not suffered any damages as a result of any

> alleged wrongdoing of the defendants because subsequent to plaintiff's purchase of AIC common stock and subsequent to the filing of this lawsuit, plaintiff could have recouped his investment or sold at a profit on the open market: therefore, entitling defendants to summary judgment in their favor. . . With this contention the Court agrees."

The District Courts in Harris and here both dismissed the complaints on the ground that the rise in the market price of the securities subsequent to the discovery of the frauds and the filing of the complaints shielded the defendant corporation from any liability. Both lower Courts reasoned that, since the plaintiffs could have subsequently sold their securities at a profit, they suffered no damages. The Court of Appeals' opinion in Harris should lay to rest once and for all that misguided notion of the law.

As stated by the Court of Appeals in Harris:

> "Where one has bought securities for long-term investment, it would be inappropriate to apply a rule requiring him to sell them prematurely for the benefit of the defrauding defendant...

* * * * *

> "Consequently, we reject the appellees' contention that Harris was under a duty, after discovery of the fraud, to sell his AIC stock for the benefit of the appellees. By continuing to hold the stock after that date Harris has, in effect, made a second investment decision unrelated to his initial decision to purchase the stock. As the court observed in Cant v. Becker & Co., supra, 379 F. Supp. at 975, what happens after this second decision has no bearing whatsoever on the measure of plaintiff's damages."

The Court of Appeals reversed the District Court in Harris, stating:

> "The validity of the district court's holding rests upon its legal determination that the defendants may be absolved from liability by showing that the plaintiff could have recouped his loss by selling his stock subsequent to his discovery of their alleged fraud, including sale after the institution of the lawsuit. We disagree with this determination."

Defendant's clamor about "punitive damages" and that Chase was not a seller of the securities in question (Br. 9-10**) has no basis. Chase could not shield itself from answering in damages for its wrongdoing because of a subsequent (after discovery of the fraud) fortuitous rise in the market price

**Br. references are to defendant-appellee's Brief.

of the Chase securities. Harris affirms this view as correct and as the law.

POINT II

THE COURT HELD IN HARRIS THAT THE DATE OF THE PUBLIC DISCOVERY OF THE FRAUD IS THE PROPER DATE AT WHICH TO ASCERTAIN DAMAGES.

In Harris, the Court of Appeals observed at the outset of its opinion that the out-of-pocket rule of damages for a defrauded purchaser of securities requires that damages should be fixed as of the date of purchase, and the measure of damages as of that date is the difference between the true value of the securities and the purchase price. The Court then noted that:

> "The Restatement of Torts observes that there may be difficulty ascertaining the value of the article transferred in connection with a misrepresentation where the misrepresentation affects the market price of the article. This is particularly true with respect to publicly traded securities:
>
> " 'The value of the article is normally determined by the price at which it could be resold in an open market or by private sale if its quality or other characteristics which affect its value were known. However, the price which determines the value of the article is not necessarily the price which it would bring at the time the sale is made. In many cases this price is due

to the widespread belief of other buyers in misrepresentations similar to that made to the person seeking recovery, as where the market price of securities, such as bonds or shares, is the result of widely spread misrepresentations of those who issue or market them. The fact that the market price is inflated or depressed by such misrepresentations is the important factor which makes the price fictitious***. [Restatement of Torts, §549, comment c at 111.]'

"Thus, where a defendant's fraudulent conduct is alleged, as it is in this case, to have caused an artificial market of long duration, damages have been fixed, consistently with the Restatement's position, not at the date of purchase but rather at the date of discovery of the fraud."

The Court of Appeals then continued:

"...we believe that in the instant case the public discovery of the fraud is the proper date at which to ascertain damages. It is only then that the market can reflect the true value of the stock, unaffected by what is alleged to have been the defendants' continuing fraud:

" '[V]alue is determined by their [i.e., the securities'] market price after the fraud is discovered when the price ceases to be fictitious and represents the consensus of buying and selling opinion of the value of the securities as they actually are.'

* * * * *

"Thus, the value of Harris' AIC stock, for purposes of computing damages, must be measured by the market price after the fraud had been discovered by the general public, i.e., when

all material facts had become known
to the public such that the market
price had ceased to be fictitious."

Harris is factually in point to the instant case.

Judge Duffy, in his opinion, and the defendant, in its reply brief, not only fail to address themselves to the question of what was the actual value (as opposed to market price) of the Chase securities while the misrepresentation was extant, but look to market price at times which, Harris holds, are not relevant. Judge Duffy looks to market price at the time of the hearing (6 months after the curative disclosure (105, 108**) to conclude that "plaintiff has now made a paper profit." Defendant, recognizing that holding as error, seeks to avoid its consequences by relegating it to mere dicta. Defendant looks to movements in the market prices of the Chase securities during the entire period that the misrepresentations were extant, and specifically at the time of dissemination of the misleading financial statement (Br. 5). Harris holds that, because the misrepresentations are then extant, the market fluctuations in that period are not relevant for determination of damages.

**Page references are to the appendix.

POINT III

THE QUESTION OF DAMAGES IS A FACTUAL ONE TO BE DECIDED AFTER PLENARY TRIAL.

Chase argues (Br. 7,8) that no trier of the facts could reasonably conclude that the declines in the market prices of Chase's securities immediately following the Rockefeller announcement were caused by the facts revealed in that announcement, because those declines were wholly within the expected range of price variances which frequently occur on a short term basis and result from the normal dynamics of an auction market. Defendant's conclusion does not follow from its premise because, as Mr. Sontag noted in his affidavit (77):

> "But that is not the same thing as saying that all such fluctuations result from the normal dynamics of an auction market, or that the price movements of the three Chase securities during the period in question resulted from the normal dynamics of the market. On the contrary, the very close time proximity between the Rockefeller announcement and the price drops of the Chase securities, and the different market movements (and non-movements) of the comparable securities compel the conclusion that there was a causal relationship between the Rockefeller statement and the prices of the three Chase securities and that the Rockefeller

statement had a negative effect on the market prices of the three Chase equity securities, including the 6-1/2% convertible debentures."

The market fluctuations of comparable securities and market indices are not only relevant, but are necessary to isolate from other market factors the impact of the Rockefeller announcement on the market prices of the Chase securities. Defendant's dismissal of the market prices of the comparable securities and the market indices as irrelevant is illogical; especially in view of defendant's self-serving conclusion that the market reaction to the announcement was "ambiguous" (Br. 8). Whether that reaction was ambiguous, the weight to be given to the comparable securities and market indices and the inferences to be drawn from them are all questions for the trier of facts upon a plenary trial.

The Sontag affidavit (75-77) supports plaintiff's damages claim. A reading of that affidavit belies defendant's twisted interpretation of it set forth in its brief.

POINT IV

DEFENDANT'S REFERENCE TO SUCH MATTERS AS SCIENTER AND RELIANCE ARE NOT RELEVANT TO THE ISSUES BEFORE THIS COURT.

(a) At a number of points in its brief, Chase alludes to its lack of responsibility for the wrongdoing alleged in the Complaint (Br. 3, 4 and 9). The question of Chase's culpability was not an issue on the motion below, nor is it an issue on this appeal. To the contrary, for the purposes of this motion, Chase's wrongdoing is deemed admitted. Shapiro v. Merrill, Lynch, Pierce, Fenner & Smith, Inc., 355 F. Supp. 264, 268 (S.D.N.Y. 1971), aff'd 495 F. 2d 228 (1974); Harris V. American Investment Co., supra.

(b) Again, without making the argument, Chase implies in its brief that for this class action to be maintained there must be individual reliance by the plaintiff on the false and misleading statements issued by Chase (Br. 2, 4). In a Rule 10b-5 class action, individual reliance by each class member is not a prerequisite for recovery. In lieu thereof, the Supreme Court has adopted the "causation in fact" test. See Affiliated Ute Citizens v. United States, 406 U. S. 128, 154, 92 S. Ct. 1456, 31 L. Ed. 2d 741, Judge

Tenney's very fine opinion and analysis in Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 353 F. Supp. 264 (S.D.N.Y. 1972) and Lewis v. Marine Midland Grace Trust Co. of New York, 63 F. R.D. 39 (S.D.N.Y. 1973). That rule, as set forth by the Supreme Court in Affiliated Ute Citizens v. United States, supra, is:

> "Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a preprequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision...This obligation to disclose and this withholding of a material fact establish the requisite element of causation in fact." 406 U.S. at 153, 92 S. Ct. at 1472.

(c) With respect to the question of jury waiver, defendant attempts to meet Rule 39's requirement of a writing by noting that the stipulation was "subsequently" entered in the record via Judge Duffy's memorandum decision (Br. 11). That strained interpretation of Rule 39 ignores the rule's requirement of simultaneous entry in the record while the parties are making the stipulation in open court.

CONCLUSION

The judgment dismissing the action should be reversed and vacated, and plaintiff granted a trial by jury.

Respectfully submitted,

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On the brief,

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Plaintiff Appellant's Reply Brief

IS HEREBY ADMITTED.

DATED: October 9, 1975

Milbank Tweed Hadley & McCloy

Attorney for Chase Manhattan Corporation